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3 Ways Fixed Annuities Can Outperform Bond Mutual Funds

HOW TO SELL SMARTER

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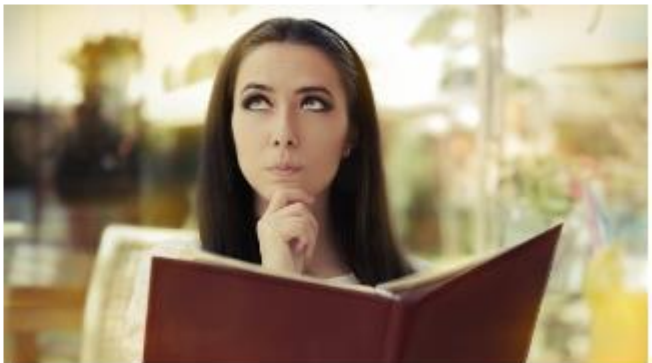

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Risky vs. safe.

How often do you break down that concept with your clients regarding their financial asset allocation? Determining what portion of a client's finances should be used for "risky" investments to maximize growth potential and "safe" options to ensure preservation of capital is one of the first — and most important — conversations a client and broker will have.

For the risky portion, it is typical for brokers and advisors to recommend stocks. For the safe allocation, many typical recommendations include money market accounts, CDs or, perhaps the most common choice, bond mutual funds.

However, for many clients, there is a lesser-known but more reliable alternative than bond funds: a fixed annuity. Why is it better? A fixed annuity can provide clients with a similar rate of return to a bond mutual fund, with greater safety.

The importance of choosing a safe route

Brokers and advisors typically recommend clients place a portion of their money in assets geared to ensure protection of principal. As clients get older, they often place a higher portion of their assets into nonstock vehicles that offer increased safety to help ensure that they stay on track for a secure retirement. Bond mutual funds are a common asset for brokers and advisors to recommend as a safe option, with most funds offering a low single-digit current yield.

However, many clients don't realize that a bond mutual fund can be risky to buy when interest rates are low. If interest rates go up, the value of your client's bond mutual fund holdings may decrease substantially — the exact opposite of what your clients expected when they were looking to find a safe place for their money.

How fixed annuities outperform a bond mutual fund

While an apples-to-apples comparison isn't exactly possible, there are a few key ways in which a fixed annuity differs from a bond mutual fund:

1. Safety

Fixed annuities can provide clients with safety. That's because both a client's original premium and any credited interest are contractually guaranteed to be protected from loss. A bond mutual fund's value fluctuates every day, and the value can decrease at any time. In fact, this can be one of the more frustrating aspects for clients, as many purchase a bond mutual fund for safety of principal, only to learn that the value can drop.

2. Earnings

The growth of a fixed annuity is often comparable to a bond mutual fund, but a fixed annuity is more predictable. Consider that a bond mutual fund can have a year when its dividend income is more than offset by a loss of principal value, whereas a fixed annuity is guaranteed never to lose value. Because of this, the earning pattern of a fixed annuity is often more attractive to clients.

3. Tax treatment

A bond mutual fund generates dividends every month, whether clients like it or not. Thus, it generates taxable income even if the fund loses value during the year. Bond mutual fund capital gains and losses would be eligible for capital gains tax treatment, but clients aren't buying bond funds for capital gains, as such gains would likely be minimal. With a fixed annuity, taxes are deferred until funds are withdrawn, so customers have more control over their taxation. For many clients, as long as they don't plan to take withdrawals until after age 59½, the taxation of a fixed annuity can be very attractive.

Foundational conversations with your clients are often about finding balance, taking into account your client's long-term financial goals and temperament for overall risk. For that safe allocation, consider how a fixed annuity purchase could be something to recommend at your next client meeting.